No. 02-603

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IN THE

Supreme Court of the United States

UNITED STATES TOBACCO COMPANY, UNITED STATES TOBACCO SALES AND MARKETING COMPANY INC., UNITED STATES TOBACCO MANUFACTURING COMPANY INC., UST INC.,

Petitioners,

v.

CONWOOD COMPANY, L.P., CONWOOD SALES COMPANY, L.P.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

REPLY BRIEF FOR PETITIONERS

NEAL R. STOLL
JAMES A. KEYTE
CHARLES S. LENT
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
(212) 735-3000

JOHN S. REED
RIDLEY M. SANDIDGE
REED WEITKAMP SCHELL & VICE PLLC
500 W. Jefferson Street, Suite 2400
Louisville, Kentucky 40202
(502) 589-1000

ERNEST GELLHORN
Counsel of Record
LAW OFFICE OF ERNEST GELLHORN
2907 Normanstone Lane, N.W.
Suite 100
Washington, D.C. 20008
(202) 319-7104

Counsel for Petitioners

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTRODUCTION	1
I. THE PETITION RAISES CRITICAL QUESTIONS OF LAW, NOT SIMPLY FACT-BOUND SUFFICIENCY ISSUES	3
II. AGGRESSIVE NONPRICE SALES PRACTICES THAT ADVANTAGED USTC DO NOT VIOLATE SECTION 2	4
III. THE STANDARDS OF PROOF FOR ANTITRUST DAMAGES ARE UNCLEAR AND IN CONFLICT	7
CONCLUSION	9

TABLE OF AUTHORITIES

CASES	Page
Blue Cross & Blue Shield of Wis. v. Marshfield Clinic, 152 F.3d 588 (7th Cir. 1998)	8, 9
Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993)	2, 5, 6
Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579 (1993)	2, 7
General Elec. Co. v. Joiner, 522 U.S. 136 (1997)	2
Image Tech. Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195 (9th Cir. 1997)	4
Integraph Corp. v. Intel Corp., 195 F.3d 1346 (Fed. Cir. 1999)	5
Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984)	3
Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999)	2
Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984)	2
Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157 (9th Cir. 1997)	4
R.W. Int'l Corp. v. Welch Food, Inc., 13 F.3d 478 (1st Cir. 1994)	4
Stearns Airport Equip. Co. v. FMC Corp., 170 F.3d 518 (5th Cir. 1999)	3, 5, 6
United States v. Lewis, 53 F.3d 29 (4th Cir. 1995)	3
United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001)	6
STATUTES	
Sherman Act, § 2, 15 U.S.C. § 2	1

TABLE OF AUTHORITIES—Continued

MISCELLANEOUS

Page

Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* (2d ed. 2002) 8

David A. Balto, *The 'Conwood' Decision*, National Law Journal p. B8 (August 19, 2002) 1

Dennis Cross, *Report From The Snuff Wars*, ABA Section of Antitrust Law, 17 Antitrust Magazine, Issue No. 1 (Fall 2002) 1

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Restatement of Torts (Second) § 892A (1979) 5

F. M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* (3d ed. 1990) 7

REPLY BRIEF FOR PETITIONERS

INTRODUCTION

Seldom has there been a deeper divide between opposing certiorari briefs filed with this Court. Petitioners ("USTC") and two amici argue that the Sixth Circuit's misguided reading of antitrust caselaw under section 2 of the Sherman Act, 15 U.S.C. § 2, directly conflicts with the rulings of this Court and of various Circuits, would severely curtail competitive practices by consumer product manufacturers and distributors, and could result, as here, in the imposition of unprecedented treble damages without proof of lost profits flowing solely from antitrust misconduct. Respondents ("Conwood") brush all this aside, suggesting that the case boils down to a prosaic dispute about the quantum of evidence needed to support a jury verdict. That is emphatically not so.

But this Court need not take our word or the analyses of amici and the impressive authorities they muster.[1] We suggest that this Court invite the Solicitor General to present the views of the United States and the Federal Trade Commission. Their perspectives are especially relevant in private antitrust litigation because "[t]he United States, which has primary responsibility for enforcement of the federal antitrust laws, has a substantial interest in assuring that the Sherman Act is construed in a manner that advances the Act's objective

[1] Three recent articles explore the concerns that the decision below will lead to a multitude of private suits and unrestrained damage awards. *See* D. Kaye, *The Dynamics of Daubert: Methodology, Conclusions, and Fit in Statistical and Econometric Studies*, 87 Va. L. Rev. 1933, 1988-2013 (2001); D. Cross, *Report From The Snuff Wars*, ABA Sec. of Antitrust Law, 17 Antitrust Magazine, Issue No. 1 (Fall 2002) (forthcoming) (lodged with the Clerk's office); D. Balto, *The 'Conwood' Decision*, National Law Journal p. B8 (Aug. 19, 2002).

of protecting the Nation's competitive economic system." Amicus Brief for the United States at 1 (Jan. 3, 1983) filed in *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984).

Conwood rewrites the Sixth Circuit's analysis in order to assert that this is a fact-bound case that "does not allege a single error of law." Opp. 1. Nothing could be further from the truth. *First*, we challenge the law applied by the lower court, not its factual summary or the quantum of evidence presented by Conwood. We likewise challenge the trial court's admission and the jury's reliance on Conwood's damages evidence—as we did at all times in the courts below—because that evidence violates the fundamental principles of *Daubert*, *Joiner*, and *Kuhmo Tire*[2] and the rulings of several Circuits.

Second, just as *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), served as a vehicle to mark the boundaries of lawful price competition, the holding here provides an optimal case for developing similarly clear and consistent antitrust rules applicable to nonprice competition. This Court has never directly reviewed the parameters of permissible everyday sales practices (e.g., the aggressive use of innovative racks, category management) or whether they can be combined with tortious conduct to become the basis for a section 2 violation.

Third, the Sixth Circuit committed grievous error when it ruled that Conwood was not required to present damages evidence disaggregating the effects of lawful conduct. As a consequence, there is no such evidence in the record because Conwood had asserted in the lower courts that "disaggre-

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[2] *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993); *General Elec. Co. v. Joiner*, 522 U.S. 136 (1997); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

gation is not a requirement," Conwood 6th Cir. Br. 61, and its damages expert assumed that only unlawful conduct could have restrained Conwood's growth in the 1990s.

I. THE PETITION RAISES CRITICAL QUESTIONS OF LAW, NOT SIMPLY FACT-BOUND SUFFICIENCY ISSUES

Conwood's primary response to virtually every argument in the Petition is that because the jury instructions were not challenged, the trial court could not have committed any "error of law" and thus there are no important conflicts among the Circuits that need to be resolved. *See, e.g.*, Opp. 13. However, instructions are intended only to guide the jury's assessment of facts and the conclusions it may draw. *See, e.g., United States v. Lewis*, 53 F.3d 29, 34 (4th Cir. 1995). The Court must determine what actions can constitute exclusionary conduct under section 2. *See, e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984) (setting boundaries of invalid tying arrangements). Here the lower court held, *inter alia*, that USTC's recommendations and suggestions to customers that they carry its products rather than those of a competitor could violate section 2. Pet. App. 26a. This expansive reading of section 2 creates a direct conflict with the Fifth Circuit's ruling in *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518 (5th Cir. 1999), and raises a profound legal question on the reach of the antitrust laws separate and apart from a proposed jury instruction on "exclusionary conduct."

Nor can Conwood escape the Sixth Circuit's erroneous analysis of USTC's marketing recommendations by pointing to the purported "outright exclusion" caused by retailer selection of USTC's racks in 21,000 stores and of CAP incentive payments in 37,000 stores. These agreements are not the result of any coercion and they cannot harm competition without showing that rivals were foreclosed from a

substantial segment of the market over a significant period of time. *See Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997) (no exclusion where agreements were of short duration and readily terminated). Conwood's undifferentiated claims do not demonstrate exclusion and are belied by the undisputed fact that its products were on more than 80% of retail store shelves in the 1990s and that new products such as the discount price value brands (led by Timberwolf) successfully entered the market. Pet. 19, 23-24. *See R.W. Int'l Corp. v. Welch Food, Inc.*, 13 F.3d 478, 488 (1st Cir. 1994) (no foreclosure or harm to competition where "new product is able to deeply penetrate the market").

Conwood's failure to distinguish legal questions from quantitative sufficiency issues is particularly evident in its discussion of the disaggregation requirement. While there is no dispute among the Circuits that the jury should be instructed that a plaintiff may not recover antitrust damages caused by lawful competition or other market forces, the Sixth Circuit now lies in conflict with other Circuits on the corollary rule that the plaintiff must provide the jury with *evidence* from which it can reasonably segregate those other effects. *See* Pet. 21-22. There was no such evidence in this case and Conwood points to none. The Sixth Circuit's attempt to fill this gaping hole by *presuming* that the jury followed the trial court's instruction, Pet. App. 42-43a, conflicts with the ruling in *Image Tech. Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1224 (9th Cir. 1997), and other cases.

II. AGGRESSIVE NONPRICE SALES PRACTICES THAT ADVANTAGED USTC DO NOT VIOLATE SECTION 2

Conwood argues that USTC's aggressive sales practices constituted illegal exclusionary conduct under section 2 because they were not "legitimate business conduct."

Opp. 14. That is false in both law and fact. Practices designed to increase sales, even at a competitor's expense, are permissible unless the practices themselves are unreasonably exclusionary. *See, e.g.*, *Brooke Group*, 509 U.S. at 222-24 (lower prices that are above cost are not exclusionary even if deliberately designed to take market share from competitors); *Stearns*, 170 F.3d at 527 (same re nonprice sales tactics). Conwood trumpets the fact that USTC's conduct included instances of unauthorized rack removals and misleading statements. While that finding might support a tort claim,[3] Conwood voluntarily dismissed those claims during trial. The mere existence of tortious acts cannot, by themselves, convert procompetitive conduct into exclusionary behavior. *See, e.g.*, *Integraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1367 (Fed. Cir. 1999) ("[e]ach legal theory must be examined for its sufficiency and applicability, on the entirety of the relevant facts"). In addition, without foreclosure of a substantial segment of the market, there can be no adverse effect on competition.

Conwood also distorts the trial record by asserting that USTC "never even attempted to offer 'valid business reasons' for any facet of" its conduct. Opp. 14. To the contrary, that was a central theme presented to the jury by USTC's fact witnesses, *see, e.g.*, JA 2000, and also the basis for arguments presented in its JMOL motion to the trial court. Indeed, the Sixth Circuit specifically noted that retailers requested USTC's racks because they were more "efficient," "enhanced demand" and "buil[t] customer loyalty." Pet. App. 6a, 18-19a.

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[3] We say "might" because the lower court identified such practices as tortious even though Conwood made no showing that they were unauthorized. *See Restatement of Torts (Second)* § 892A (1979). Instead, the Sixth Circuit shifted the burden to *USTC* requiring it to show that "these acts were authorized by the stores." Pet. App. 25a.

That USTC executives, including its chairman, did not condone examples of unauthorized rack removal and product displacement is, of course, wholly beside the point. Candid acknowledgment that some actions were contrary to the company's standards is not evidence of antitrust misconduct. *See, e.g., Brooke Group*, 509 U.S. at 225.

Finally, Conwood's attempt to discount the intercircuit conflicts regarding proof of section 2 liability is not persuasive. First, *Stearns* did not simply involve a monopolist "'vigorously stressing the qualitative merits of its product'" as Conwood argues. Opp. 17. The Fifth Circuit expressly held that an "orchestrated" campaign to take business from a competitor through "wrong, misleading or debatable" conduct did not violate section 2 because the customers (like the retailers here) were free to consider proposals from rival suppliers and because the purpose of that conduct was to increase sales of defendant's products. *Stearns*, 170 F.3d at 521 & 524. It cannot be disputed that the same open competitive process and the same rational business purpose justified USTC's sales practices. Pet. App. 6-7a, 26a.

Second, *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001), cannot be read as supporting Conwood's argument that a section 2 plaintiff need not prove that a significant segment of the market was foreclosed. In *Microsoft*, the D.C. Circuit specifically held that plaintiff must prove foreclosure of a "substantial percentage" of market opportunities. *Id.* at 70-71. Its finding of liability was based on Microsoft's shutting Netscape out from virtually all outlets. *Id.* Had there been meaningful exclusion here, USTC's competitors would not have been able to double their market share in the 1990s, nor would new brands have been able to capture a significant market share during 1994-98.

III. THE STANDARDS OF PROOF FOR ANTITRUST DAMAGES ARE UNCLEAR AND IN CONFLICT

Seeking to avoid the imperative need for this Court's clarification of proof of antitrust damages, Conwood oddly argues that USTC has "abandoned" its *Daubert* challenge to the admissibility of the Leftwich and Rosson testimony. In the same breath, however, Conwood admits that "most of the cases cited by USTC" are "*Daubert* cases dealing with the 'gatekeeper' function of the court in admitting expert testimony," Opp. 28, thereby conceding that our Petition pointedly includes a challenge based on Circuit conflicts derived from the *Daubert* trilogy.

Conwood further seeks to justify its damages judgment by arguing that Leftwich's study relied on "accepted statistical methods," reviewed "an array of additional hypotheses," and "considered and ruled out all of the additional alternative 'explanations that USTC's own expert suggested.'" Opp. 25-27. However, this attempted diversion only highlights the bankruptcy of Leftwich's theory. That hypothesis posits that Conwood's sales percentage in low share states should have increased the same amount as in high share states regardless of past experience; and any failure to meet that growth target is presumed to be the result of exclusionary conduct. But that theory is devoid of economic content, has never been tested, has never been subject to peer review and publication, and has never been applied in any other antitrust case. *See Daubert*, 509 U.S. at 593-94. Indeed, the critical assumption of Leftwich's theory—that poor performance by Conwood in low share states can be explained only by exclusionary practices rather than normal market forces—is contrary to basic economics. The moist snuff market is a four-firm oligopoly and peer reviewed literature shows that such markets generally exhibit stable market shares. F. Scherer & D. Ross, *Industrial Market Structure and Economic*

Performance 90 (3d ed. 1990) (reviewing empirical literature). That is, Leftwich's statistical study purported to identify a phenomenon that is so common that it occurs at a statistically significant level in 90% of oligopoly markets. *See, e.g.,* M. Gort, *Analysis of Stability and Change in Market Shares*, 71 J. Pol. Econ. 51 (1963). Oblivious to this history, Leftwich's finding that market share stability proved the existence and effect of USTC's exclusionary practices is scientifically unsound.

Conwood's contention that Leftwich applied traditional before-and-after and yardstick tests is transparently false. While Conwood asserts that Leftwich used these standard tests in assessing the validity of his low share state theory, *see* Opp. 25, his study did not even approximate recognized applications of either method.[4] Properly applied here, both tests show zero damages. That is, Conwood's share increase (the variable selected by Leftwich) was *greater* during the injury period of 1990-97 than an equivalent nonviolation period of 1983-90,[5] and Conwood's share in fact declined in the yardstick market of smokeless looseleaf tobacco where USTC did not operate. JA 1147; *see* Pet. 7. *See generally Blue Cross & Blue Shield of Wis. v. Marshfield Clinic*, 152 F.3d 588, 592-94 (7th Cir. 1998) (Posner, C.J.).

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[4] Under both tests, the researcher selects a variable for performance (profits, growth or revenue) and compares the plaintiff's performance in the nonviolation market with its performance in the violation market. *See* P. Areeda & H. Hovenkamp, 2 *Antitrust Law* ¶ 391e, f; 396e, f (2d. ed. 2000).

[5] The record is undisputed that Conwood's nationwide market share increase during the 1990-97 violation period was 3.0 points (increasing from 10.6 to 13.6%) whereas it increased 2.9 points during the comparable 1983-90 nonviolation period (increasing from 7.7 to 10.6%). JA 2787; *see* Pet. 7. Thus, Conwood's performance in the moist snuff market actually exceeded its projected "but for" performance.

Conwood's attempt to demonstrate that its damages evidence disaggregated lawful from unlawful acts cannot stand scrutiny. It argues (i) that Leftwich said he intended only to measure unlawful conduct so disaggregation was unnecessary, and (ii) that this was confirmed by his test of suggested alternatives for which he had data. These propositions are contradicted by Leftwich's own theory and real world facts. First, if Conwood was too weak to resist USTC's conduct without a foothold in the low share states, it was similarly too weak to stave off inroads from Swedish Match's Timberwolf (and 11 other brands) that entered the market in the 1990s or the effects of lawful category management decisions by retailers to prune slower moving brands. Second, Conwood concedes that Leftwich did not test for the effects of any of these *most likely plausible alternative* explanations for Conwood's slower growth. *See, e.g.*, *Blue Cross*, 152 F.3d at 593 ("Statistical studies that fail to correct for salient factors, not attributable to the defendant's misconduct, that may have caused the harm of which the plaintiff is complaining[,] do not provide a rational basis for a judgment.") This Court should not condone bad science or encourage a failure to develop data necessary to support a damages study.

CONCLUSION

Ultimately, what should disturb this Court most of all is that the largest private antitrust judgment in history involved no cognizable antitrust misconduct and was based on a fanciful use of economic science designed to avoid established limits on antitrust damages.

For the foregoing reasons and those in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

NEAL R. STOLL
JAMES A. KEYTE
CHARLES S. LENT
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
(212) 735-3000

JOHN S. REED
RIDLEY M. SANDIDGE
REED WEITKAMP SCHELL &
VICE PLLC
500 W. Jefferson Street,
Suite 2400
Louisville, Kentucky 40202
(502) 589-1000

ERNEST GELLHORN
Counsel of Record
LAW OFFICE OF ERNEST
GELLHORN
2907 Normanstone Lane, N.W.
Suite 100
Washington, D.C. 20008
(202) 319-7104

Counsel for Petitioners

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